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### Reform of in-kind benefits in Russia: high cost for a small gain

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**Summary** Based on national legislation passed in the summer of 2004, Russia implemented wide-ranging changes to its system of category-based social benefits in January 2005. Implementation difficulties made headlines around the world. This article discusses the structure of the reforms and examines the extent to which they: (a) reduce or eliminate the categorical allocation of public resources; (b) replace in-kind benefits with cash transfers; and (c) target benefits, in whatever form, to low-income people. The overall conclusions are that the reforms score very badly against criteria (a) and (c), but get a middling score for cashing-out benefits.

**Key words** monetization, social assistance, social benefits

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### Introduction

A principal social sector legacy of the socialist-Soviet system to the countries of Eastern Europe and the former Soviet Union (USSR) was a network of in-kind benefits allocated to various categories of citizens, regardless of their economic situation. From targeting and consumer choice perspectives these left much to be desired (Milanovich, 1998; World Bank, 2000). For the governments of the region, including the countries joining the European Union, reforming this system has been a principal and demanding task.

The topic of cashing-out social benefits previously provided in kind has occupied the front pages of the Russian media since the summer of 2004, and was associated with waves of social unrest early in 2005, when the legislation defining the reform came into effect. The essence of the reform was to delineate federal and regional social protection mandates, cash-out some of them, and make funding these mandates more transparent. The system of non-cash social benefits (called 'privileges' or

*lgoty*) had been widely criticized by Russian and international experts for being regressive, ineffective as protection to the poor, and non-transparent.

Has the reform led to improvement in these areas? The objective of this article is to assess the design and implementation of the reform which transforms the system of in-kind privileges in Russia. The assessment is based on the principle that greater efficiency of social protection should be the desired outcome of the reform. The policy implications for the imperfect reform rules actually implemented are discussed in the context of the regional-level decisions made in response to the federal legislation setting the framework.

The article is organized as follows. The second section describes the old system of in-kind privileges and gives economic and social rationales for its reform. The third section analyses the reform rules against several criteria related to the reform objectives. We show that in order for it to have been successful, the reform of in-kind privileges should have been focused on the transparency of public expenditures,

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improved targeting of the poor, and a wider freedom of consumer choice achieved through more assistance from payments made in cash rather than in kind. We find that the reform design did not meet these criteria sufficiently. The fourth section goes on to address implementation issues affecting the social and fiscal consequences of the reform. In the fifth section we compare the reform of privileges in Russia with other transition countries, to show the key differences in approach and the results achieved. The sixth section concludes.

### The legacy of in-kind privileges and the need for reform

On-going debate about how the social dimension of policies can be revisited and strengthened in an enlarging European Union (Hemerijck, 2005) show that the heritage of the post-communist systems for the social protection of the latest EU members continues with its high-profile political problems and risks of fiscal unsustainability, not only for the new member countries but perhaps even for the entire EU. Excessive non-cash benefits provided to various groups of 'privileged' people – mostly the elderly and people with disabilities – led to: (a) substantial labour market inefficiencies; (b) the motivation of communist countries to reduce the retirement age; (c) the creation of welfare traps instead of the promotion of inclusion into the labour markets; (d) for a while, helping to hide the economic weaknesses of transition societies. The solutions implemented by transition countries to reform their social policies remain outside best practice implemented by the EU-15 countries, and Western European models also proved not to be fully applicable to the transition environment (Tomes, 2005). While Russia stands aside from the debates on Social Europe, it represents perhaps the most outstanding case of social policies and practices to be avoided by countries building an efficient social safety net that can function sustainably in a European market economy.

By the Brezhnev era, the system of in-kind assistance had evolved to provide benefits to three distinct classes of beneficiaries: (a) the 'deserving disadvantaged', that is, those who mostly, through no fault of their own, would suffer impoverishment in the absence of assistance (e.g. orphans, the disabled and the elderly without pensions); (b) those who had rendered special service to their country (e.g. labour

heroes, veterans of the Second World War and other conflicts, and those who worked in particularly hazardous professions or demanding locations, such as first responders at Chernobyl); and (c) those providing current services to the state, where benefits provided a hidden salary supplement (e.g. members of the military, the security services and judges). The system entailed dozens of benefits and dozens of groups with an extremely large set of combinations of privileges and beneficiary categories.

Transition to the market economy brought about new social phenomena such as unemployment and poverty – not recognized under the Soviet Union – and wage and pension arrears. New regional, national and municipal social programmes appeared in response, but they were usually based on the same categorical principle that existed before, although there were notable pilot programmes which demonstrated that stronger targeting without categories was possible. Following the categorical principle was the easiest course of action for administrators at all levels. As reported by the World Bank (2000), 'privileges proved difficult to reorient towards the poor'. This is rooted in the system design. For instance, under the free provision of energy benefits, the more appliances a household possesses and the more lights it runs, the greater the benefits coming from greater electricity consumption. In the same way, better-off households have greater benefit from housing privileges. Transport benefits are regressive in a different manner, since by default they exclude the people who are not able to use transport because they either live in rural areas not served by public transport, or have physical (health) constraints which prevent them from travelling. The poor suffer disproportionately from the low quality of services, because, unlike wealthier groups of the population, they often cannot afford private services, while public services are of low quality. As for in-kind privileges, clients do not have a choice either from the provider or from the goods and services themselves.

Throughout the 1990s, decisions to introduce new privileges were often taken at the federal level, but the budgets of regions (equivalent to states or provinces) or localities were required to fund them.<sup>1</sup> Poorer areas, therefore, were the least able to match public liabilities with their budget resources. Unfunded mandates were still delivered by service providers, such as housing, transport companies or clinics. The fiscal gap translated into lost revenues

for these providers, creating additional burdens for regional and local economies, thereby preventing effective enterprise from restructuring. This burden was a heavy one: privileges were equivalent to 4.2 percent of GDP in 2002 compared to targeted social assistance programmes that accounted for 0.4 percent, and an estimated 70 percent of the population, *de jure*, enjoyed one or more of these (World Bank, 2004b).

Lack of transparency in resource allocation cannot be underestimated when the system of privileges is assessed. By design, consumption of many privileges could not be made transparent in Russia, with its extremely weak administrative capacity. Free city transport provides an example where there is no mechanism for tracing how many pensioners permitted to ride for free are actually using the transport, of what kind, how many times a day and for what distances. Transport companies make arbitrary estimates of the revenue gap they would like to have closed from the budget and submit their applications to fiscal authorities which, in turn, have no means to verify or reject this estimate. They then react with an equally arbitrary response, more often based on what resources are available.

In short, the driving force behind the reform of privileges was the excess burden of non-affordable social mandates which are non-transparent, and fail to target public resources to the poor. Transformation of in-kind privileges into cash benefits (also known as 'monetization') was supposed to increase transparency of the expenditures, give beneficiaries freedom of choice, and simplify administration. As for affordability, to achieve this goal, monetization needs to be complemented by a stronger targeting of the benefits to the low-income population, and a corresponding reduction of those in beneficiary categories. Not all these goals were achieved, as will be described.

### The Russian reforms: structure and design problems

The reform notionally started on 22 August, 2004, when President Putin signed the law No. 122-FZ, uniformly referred to as 'The Law on Monetization'. According to this law, the new system of privileges had to be defined and come into force by 1 January 2005. Monetization is used colloquially to mean 'cashing-out'. The law in fact does not

address monetization *per se*; rather it focuses on delineating a large set of financial responsibilities (not only in the social protection area) between the federal government and the regions. According to this delineation, measures of social support for the beneficiaries of several large groups of in-kind privileges, such as labour veterans or former victims of political repressions, must be re-determined and subsequently financed entirely by the regions. Responsibilities for certain groups of privilege beneficiaries (e.g. people with disabilities or Second World War veterans) are determined by the law to be federal responsibilities. The law details the changes for them, such as the introduction of cash payments, the removal of certain privileges, and the introduction of the so-called social package, which hardly differs from in-kind privileges. It also organizes payments through the pension system.

The content of the law concerning social assistance is summarized in Table 1. The table is designed to illustrate the changes and covers two groups that are the responsibility of the federal government, and the three main groups that are now the responsibilities of the regions.

To judge the reform from the social protection efficiency viewpoint, we examine the outcomes and ask whether it should have resulted in: (a) better targeting; (b) higher transparency of expenditures; (c) simplified operations; and (d) wider consumer freedom. We have used three criteria in this assessment. They are the degree to which:

- categorical allocation of public resources is eliminated or reduced;
- in-kind benefits are replaced by cash transfers;
- benefits, in whatever form, are targeted to low-income people.

### *Categorical provision*

It is already clear from the table that the principle of categorical provision has not been changed. The system was somewhat streamlined, since some narrow categories were excluded. For instance, prior to 2005, housing privileges covered not only the categories defined by legislation, but their family members as well, and for many groups of beneficiaries, such as teachers, the housing privilege is now provided only to the beneficiary. Students studying in the regions of the far North lost their annual right

**Table 1** Changes resulting from social reforms in 2004 for selected programmes by responsible level of government

<i>Beneficiaries</i>	<i>Benefits before 'monetization'</i>	<i>In-kind benefits remaining in 2005</i>	<i>Cash benefits introduced since 2005</i>
<b>RESPONSIBILITY OF THE FEDERAL BUDGET STARTING FROM 2005</b>			
WWII veterans and participants (total of 8 subcategories within this group)	<ol style="list-style-type: none"> <li>50% discount on housing and utility services.</li> <li>50% discount on guard services for single living persons or pairs.</li> <li>Free provision of medicines.</li> <li>Free denture services.</li> <li>Free provision of prosthetic devices.</li> <li>Free urban, suburban and inter-city transportation.</li> <li>Railroad and water commuter services.</li> <li>Once in every two years (or 50% discount once a year) free two-way ticket on rail, water, air or bus services.</li> </ol>	<ol style="list-style-type: none"> <li>50% discount on housing and utility services.</li> <li>Free provision of prosthetic devices.</li> </ol>	<ol style="list-style-type: none"> <li>2,000 rubles (to WWII invalids), 1,500 rubles (WWII participants), 1,100 or 600 rubles (others) (came into force from 1 January 2006).</li> </ol>
Disabled equipment	<ol style="list-style-type: none"> <li>Free provision and repair of rehabilitation equipment or compensation for equipment purchased.</li> <li>Free provision of transport or compensation for transport services.</li> <li>Free provision of medical and domestic services (if needed).</li> <li>50% discount on telephone and wired-radio services.</li> <li>For those not working – free provision of sanatorium-resort therapy.</li> <li>For those working – privileged provision of sanatorium-resort therapy.</li> </ol>	<ol style="list-style-type: none"> <li>Free provision and repair of rehabilitation equipment or compensation for equipment purchased.</li> <li>Free parking for special cars.</li> </ol>	<ol style="list-style-type: none"> <li>1,400, 1,000, 800 or 500 rubles, depending on the degree of disability, as defined by state experts (came into force from 1 January 2006).</li> <li>Payment for transport to prosthetic-orthopedic organization (depending on transport cost).</li> <li>Payment for accommodation when they are travelling to prosthetic-orthopedic organization (depending on number of days' stay).</li> </ol>

*(continued)*

Table 1 (Continued)

Beneficiaries	Benefits before 'monetization'	In-kind benefits remaining in 2005	Cash benefits introduced since 2005
	<ol style="list-style-type: none"> <li>7. For disabled and their attendants – urban, suburban and intercity transportation.</li> <li>8. For disabled or for a disabled person (1st degree) and their attendant – 50% discount on railroad, water or air commuter services in period 1 October till 15 May or once a year free return ticket on railroad, water, air, or bus services at other times.</li> <li>9. For disabled person (1st and 2nd degree) and for disabled child – once a year free return ticket to the place of treatment.</li> </ol>		
RESPONSIBILITY OF THE REGIONAL BUDGETS STARTING FROM 2005			
Labour veterans	<ol style="list-style-type: none"> <li>1. Receiving old-age pension – denture services.</li> <li>2. Urban, suburban and intercity transport.</li> <li>3. 50% discount on railroad and water commuter services.</li> <li>4. 50% discount on housing and utility services.</li> <li>5. 50% discount on solid fuel provision.</li> <li>6. 50% discount on telephone services.</li> <li>7. 50% discount on wired-radio services.</li> <li>8. 50% discount on antenna services.</li> </ol>	To be defined by regions of the Russian Federation	To be defined by regions of the Russian Federation

(Continued)



Table 1 (Continued)

Beneficiaries	Benefits before 'monetization'	In-kind benefits remaining in 2005	Cash benefits introduced since 2005
Victims of political repressions	<ol style="list-style-type: none"> <li>For rehabilitated – compensation = 75 rubles* (# months of imprisonment) but not more than 10,000 rubles.</li> <li>For rehabilitated – seized property or compensations for it (but not more than 400 rubles for property without dwelling and 10,000 rubles for property with dwelling).</li> <li>For rehabilitated pensioners and disabled – 50% discount on provision of medicines.</li> <li>For rehabilitated pensioners and disabled – urban, suburban and intercity transport.</li> <li>For rehabilitated pensioners and disabled – rail and water commuter services.</li> <li>For rehabilitated pensioners and disabled – once a year return ticket on railway or 50% discount on return ticket on water or air services.</li> <li>For rehabilitated pensioners and disabled – 50% discount on housing and utility services.</li> <li>For rehabilitated pensioners and disabled – 50% discount on solid fuel provision.</li> <li>For rehabilitated pensioners and disabled – free telephone installation.</li> </ol>	<p><b>To be defined by regions of the Russian Federation</b></p>	<ol style="list-style-type: none"> <li>For rehabilitated – compensation = 75 rubles* (# months of imprisonment) but not more than 10,000 rubles.</li> <li>For rehabilitated – seized property or compensations for it (but not more than 400 rubles property without dwelling and 10,000 rubles for property with dwelling).</li> </ol> <p><b>Others to be defined by regions of the Russian Federation</b></p>

(Continued)

Table 1 (Continued)

Beneficiaries	Benefits before 'monetization'	In-kind benefits remaining in 2005	Cash benefits introduced since 2005
Home-front workers during WWII	10. For rehabilitated pensioners and disabled – denture services.		
	11. In case of the rehabilitatee's death – funeral at the expense of the state.		
	1. Zero interest credits for building.	To be defined by regions of the Russian Federation	To be defined by regions of the Russian Federation
	2. 50% discount on provision of medicines.		
	3. Denture services.		
	4. Free provision of prosthetic devices.		
	5. Urban, suburban and intercity transport.		
	6. 50% discount on railroad and water commuter services.		

to one-off free transport to 'the place of medical treatment'. Free transport was abolished for policemen. A striking fact is that due to the complexity of the system there is no official assessment yet of what were the overall reductions in the number of categories or the number of privileges, even though such information is crucial for fiscal impact analysis and forecasting.

Nevertheless, the majority of the categories remain untouched and in addition these categories are now split by sources of funding into 'federal' and 'regional' subgroups. A huge drawback is that this division was never explained by the government and no rational criteria can be seen for it. For the general public and regional public authorities, one of the main problems is that two groups of veterans who have always had almost equal treatment according to the law 'on veterans' (i.e. Second World War veterans and labour veterans) are now in two different subgroups and social protection measures for them are unequal. Labour veterans demanded from their regional authorities the same amount of benefits as was provided by the law to Second World War veterans. But for many regions this is unaffordable; so the choice was often between a budget crisis and protests from labour veterans.

A powerful illustration of the negative incentives created by arbitrariness in splitting privilege categories by levels of funding is the phenomenon of 'invalidization' which was observed in many regions in the autumn of 2005, when the new law had already defined the benefits for people with disabilities (category 'invalids'), but at the time the regions were only starting to define social protection measures for the groups assigned to them. Many people belonging to the 'regional privileges groups' are elderly, and the current system of disability assessment allows them to translate poor health conditions into the privileged status of a 'disabled' person. Unsure that regional authorities would provide them with the amount of benefits equal to the federal level definition, elderly people flooded the disability assessment commissions and were classified as 'disabled'. This not only allowed them to claim federal benefits instead of regional ones, but caused a fiscal crisis at the beginning of 2005, when the number of federal beneficiaries exceeded the budget projections. The government failed to monitor 'invalidization', and the number of people who converted to disabled status because of the fiscal incentive remains unknown. The authors themselves were present in a region

where the social protection authorities, asked by their local counterparts about what to do with a mass influx of 'to-become-invalids', advised them to accept as many applications as possible since it would reduce their future expenditures and increase transfers from the federal budget.

The division of privileged categories into two groups did, however, create positive incentives for the establishment of transparent accounting and information systems. Unified social registries have been tried by some regions, and the databases were cleaned and updated before the new system of payments started in 2005. During this process many regions updated previous information on the number of privilege recipients, which helped to improve their fiscal estimates. In many regions, the process of database formation was somewhat problematic as interdepartmental interactions are slow and often inefficient, especially where non-social agencies, such as military draft commissions or Interior Ministry departments, are concerned.

### *Cashing and targeting*

At the federal level, the story is clear and simple: cash benefits were introduced by national law. All of them are flat benefits and no targeting is implied (see Table 1). The situation for regional governments is dramatically more complex. Notionally, the law gives regions full freedom to define social protection measures for labour veterans, families with children, victims of political oppression and home-front workers. However, the same law contains a clause saying 'when the changes in the system of privileges and benefits are made, the total amount of their funding cannot be reduced and the provision cannot be worsened'. The terms 'total funding' and 'provision' can have multiple interpretations. For instance, the total funding may or may not include the lost income of service providers. It may or may not count municipal resources which had been provided to finance in-kind privileges when federal or regional transfers had not been allocated in the required amounts. With regard to the second term, it is often believed that if a veteran was eligible to use public transport free of charge, then replacement of this right by a cash benefit that requires going to the bank and buying a ticket is an increase in the veteran's transaction cost and therefore means a 'worsening of the provision'. At the

same time, the fact that not all veterans are physically able to use the transport they are eligible for is ignored. From the government's side, this is a substantial disincentive to cash the benefits out, since all those eligible will receive cash payments.

### *Benefits to low-income people*

Today, the fact is that not a single regional government has introduced targeting of categorical social assistance to low-income people or households, at least within the defined categories. Social protection authorities have noted that unclear rules of the game cause them to avoid targeting, so that they are not charged later by the Prosecutor General's office for worsening the conditions of the non-poor, who would lose as a result of targeting the poor. This is a visible anomaly of the reform rules which reduces their potential value. If targeting had been allowed, the transformation of in-kind privileges into cash benefits could have contributed to poverty reduction, if at least some of the benefit expenditures were focused on the low-income households.

Responding to mixed signals coming from the federal level, the regions have acted very cautiously in cashing-out benefits. A review of regional legislation, (for details, see Alexandrova et al., 2005) finally adopted by spring 2005, shows:

- An absolute majority of the regions kept housing and utility privileges in the in-kind form.
- More than two-thirds keep solid fuel provision in kind (e.g. wood for wood-burning stoves in rural areas).
- About half the regions retain in-kind dental services for all categories, and the privileges for medical drugs for the home-front veterans and victims of political repressions.
- A third of the regions did not transform or cancel the free provision of city and suburban transport for all categories of regional beneficiaries.

Table 2 shows how many regions (out of the 79 reviewed) removed some of the in-kind privileges for the main groups which fell under their domain. The first line shows the extent to which any reform at all was avoided. Among the regions where no monetization took place, we can name Chukotski Okrug, Northern Ossetia, and Khabarovsk Krai. The second line, where the majority of the regions

**Table 2** Transformation of in-kind benefits by Russian regions in implementing Russian Federal Law 122

	<i>Labour veterans</i>	<i>Home-front workers</i>	<i>Victims of political repressions</i>
In-kind privileges remain	10	17	9
Partial monetization	65	34	67
Full	4	28	3

*Source:* Institute of Urban Economics survey of regional social assistance offices.

is concentrated, reflects the frequency of moderate reforms, where some cash benefits were introduced and some (usually not major) privileges, such as free inter-city transport, were removed. As for complete monetization, the third line of the table shows that there are three leaders: Yamalo-Nenetsky autonomous area; Tverskaya oblast; and the Republic of Tatarstan, which even 'monetized' housing privileges across the categories. Tumenskaya and Vologodskaya oblasts are close to the leaders, but they did not touch housing privileges. Breaking the number of regions down by beneficiary groups shows that there was more willingness to monetize privileges for home-front workers – not a numerous group and the one that had the smallest number of privileges provided to them (see Table 1). About a fifth of the regions left the system of privileges untouched for all categories.

The introduction of the new system was met with demonstrations in many regions. A substantial share of regions responded by enriching the benefits. Vologodskaya oblast is an example of where the authorities intended to cash-out housing privileges, and even announced this to the population. But as a result of regional parliamentary discussions, possibly affected by protests against the reforms (not so much in the region, but nationwide), they ended up keeping housing privileges in-kind and reduced the initially planned amount of monthly cash payment from Rub.700–500 to provide the budget for the in-kind housing privileges.

### Reform implementation and related issues

Implementation can critically influence the success or failure of reforms and aspects of implementation cannot be ignored when assessing the transformation of privileges in Russia. Implementation literature across the world suggests that leadership commitment, project design, human and financial resources, institutional contexts, and openness to

change are among the key determinants of the reform's success on the ground.<sup>2</sup> It appears that preparation of the monetization reform failed to take these factors into account. The most obvious failure was in leadership; that is to say, in severely underestimating the size of the implementation task when preparing the legislation, particularly the time required to organize such wide-ranging administrative changes.

The administrative capacity of the Russian social protection system, or lack thereof, has been scarcely documented, but the available studies suggest that little development has been made since the Soviet period. A World Bank report (World Bank, 1994) identified the system as 'inadequate to deal with the type and scale of needs created by transition' and noted that enormous variations in the economic fortunes of the regions, which were largely responsible for social assistance programmes, led to adverse correlations between poverty and resources spent on social assistance. Later, Gallagher and Struyk (2001) identified such specific administrative problems as the absence of service and operational standards, lack of exposure to best practices and a general reliance on upper-level administrators to come up with policies and solutions. An important observation from a limited number of studies (e.g. Struyk and Petrova, forthcoming) is that implementation is very sensitive to local environments, including political priorities, bureaucratic constraints and resources.

In respect of the human and other resources of the social protection system, capacity is very unequal across Russia. But no methodological guidance or technical assistance was offered to any region or locality by the federal Ministry of Labour and Social Development agency, which was in charge. Regional and local social protection officers had no information or standardized guidance on how to deal with the difficult or dubious legal clauses, how to provide information to clients, how

to work with difficult clients, or what database standards, operational procedures and re-certification mechanisms to use. In Russia there is a scarcity of specialists who are familiar with modern standards of social-assistance programme design, targeting techniques, fiscal impact assessment methodologies and proactive methods of work with vulnerable clients – especially from such groups as the elderly or people with disabilities. Therefore the administrative system was unable to mobilize the human resources needed to go beyond the short-term task of compiling the database on federal beneficiaries to be, and transferring it to the Pension Fund for administration. There was no capacity for the restructuring of social protection in a more comprehensive way, including the system parameters and operational mechanisms.

Payment of cash benefits through the Pension Fund is itself an implementation issue. The government decided that for the federal categories, cash benefits would be paid through this channel since almost all the beneficiaries are pensioners anyway. The decision included efforts to improve the accounting and records system, by using the resources of the Pension Fund which are stronger than social protection system resources. Between August 2004 (when the law on monetization was adopted) and 1 January 2005 (when the reform came into effect), social protection authorities had to focus their limited capacity on composing and verifying databases on privileged categories. Databases for ‘federal’ categories had to be transferred to the Pension Fund, local data had to be integrated with those of the regions, so that administration of social assistance provision to ‘regional’ groups could be made uniform within each region. No resources were in the meantime put into training personnel and organizing social or Pension Fund offices so that they would be prepared to deal with large inflows of clients who needed to re-certify their status or needed information and assistance.

The decision to transfer the cash payment task to the Pension Fund was probably optimal in terms of a quick arrangement to administer universal flat benefits across the country. But the Pension Fund system is not designed to work with means tests, so that, again, no future targeting is administratively possible. Moreover, there is now a disincentive for social protection agencies to establish a comprehensive approach to assisting households. This is because

they have given away a large part of the essential data on assistance sources and because the person-based, not the household-based principle of assistance is now well fixed throughout the system. To use the Pension Fund data in future, a social office will need to make them compatible with its own data, train personnel, and invest in data exchange systems.

Lack of outreach efforts and client information in advance of implementation has been noted by many experts<sup>3</sup> as a possible cause of public concerns and even protests. During the four months between adoption of the law and its coming into force, regional authorities had to determine the extent to which the previously existing system of privileges would remain, or be replaced with other forms of social protection. It meant that legislation needed to be redrafted, fiscal estimates made, parliamentary discussions and passage of the legislation organized. Even by the end of the year many regions did not have a clear picture of how the system of social protection for their privileged groups would finally look. Given that Russian social authorities generally do not have a well-established tradition of consulting with their clientele, it is no surprise that under conditions of uncertainty and time constraints no effort was put into public information and stakeholder discussions of the proposed policies.

Another big flaw in reform implementation was the lack of information for helping to make policy decisions. Neither the Federal Ministry nor regional authorities possessed accurate information on the number of beneficiaries and the actual use of the privileges. The practice was to base monetization decisions on the available budgetary resources, and some vague understanding of how many people might present themselves for cash benefits. This understanding was never based upon any simulation of changes in participation rates which occur when an in-kind benefit is monetized. As a result, in January 2005, when privilege recipients re-registered for cash benefits, the Ministry of Finance declared that the initial fiscal estimates had proven insufficient. The government at the federal level initially planned to spend some Rub.170b to finance cash payments, but according to the head of the Expert Department within the Presidential Administration, Mr Dvorkovich,<sup>4</sup> an additional Rub.300b had to be found and reallocated to cover the underestimated gap.

More importantly, the government made no effort to assess the distributional impact of such an important reform using household-level data. The 2003 National Survey of Household Welfare and Program Participation (NOBUS) could have been used to simulate reform impacts, at least in part. Only recently a few independent studies have emerged, covering the consequences for households. One (Volchkova et al., 2006) shows that some 22 percent of households, mostly urban and of older age, would lose out. Until housing privileges are monetized, the overall distributional effect simulated by Volchkova et al. appears quite positive. This is because the majority of 'losers' are the non-poor, while the poorest families, single pensioners apart, tend to gain from monetization. However, possible future reform of housing privileges will affect poor households severely, and the government will need to allocate large subsidies to mitigate the potential negative effects. The existing housing allowance programme offers a ready vehicle for a targeted distribution of these subsidies.

Another study (Independent Institute for Social Policy, 2006), using NOBUS, concludes that monetization might reduce cash poverty from 32.2 percent to 26.8 percent; but this effect will be wiped out by increased prices for housing utilities and medical services, previously provided as privileges. Finally, an unpublished article based on a survey in one region (Struyk et al., unpublished) compares the actual situation of households with privileged members after the monetization of regional transport privileges. After measuring changes in consumption, local travel, and perceived changes in their standard of living, the article finds that rural beneficiaries fared better than their urban counterparts. Simple comparisons of outcomes between low-income and high-income households revealed essentially no differences, but the multivariate analysis – where separate models were estimated for urban and rural households – showed a broad pattern of beneficiaries in households with lower economic resources faring less well, although the overall effects are not large.

### Reforms in other CIS countries

To put Russia's reforms in perspective, it is useful to compare them with those undertaken by other Confederation of Independent States (CIS)

countries. We survey the changes implemented in Kazakhstan and Moldova, two comparatively early social assistance reformers for which there is good information available. This article concentrates on programme structure; in both countries, underfunding of some programmes is known to be a problem.

#### *Kazakhstan*

Between 1998 and 2000, Kazakhstan<sup>5</sup> enacted a series of reforms to its social assistance system. In some respects the strategy resembled that employed by Moscow, but the Kazakh reforms were more extensive.

Reforms resulted in four main social assistance programmes. The first, Special State Allowances (SSA), resembles the results of Russia's monetization programme. SSA replaced earlier existing cash and non-cash preferences and discounts designed to pay for housing maintenance and utilities, fuel, telephone, medicines, spectacles, public transport, periodical subscriptions, treatment at sanatoria, and others which served more than 30 population categories. The special state allowances are now paid in cash to the following eligible categories: Second World War veterans, the disabled, individuals who were involved in tackling the Chernobyl catastrophe, families of military personnel who died on duty, individuals awarded orders or medals, victims of political repressions, mothers and families with many children. Different beneficiary categories receive different benefit levels.

The second programme is Targeted Social Assistance (TSA) which replaced programmes such as child and birth allowances, payment for funerals, and similar programmes. A cash payment provided to households having an average per capita monthly income below the poverty line set for each oblast. The size of the assistance is estimated as the difference between the average per capita household income and the poverty line in the region for each eligible household member. Eligibility is confirmed by local government authorities based on the recommendations made by the specially created district commissions. The programme is funded by local budgets.

TSA bases eligibility only on income, not on population categories, and in this respect goes much further than the Russian reforms, including the policies



implemented to date by regional governments. World Bank experts rate its targeting as highly effective.

Housing allowances are the third programme. Payments are provided to low-income and socially protected groups of the population to cover expenses on housing maintenance, utilities, and leasing of housing from the state housing fund. Housing assistance is extended to poor households if the actual housing and utilities expenses exceed a certain percentage of the aggregate household income defined by the local government. The size and method for determining housing assistance is defined by local governments and targeting performance is not strong.

The final programme is State Social Allowances which pays the disability allowance, survivor allowance, and old-age allowance.

Overall, the changes are impressive. All four programmes make cash rather than in-kind payments. A sharp streamlining and reduction in the number of categories entitled to benefits was achieved. Importantly, two of the programmes – the TSA and Housing Allowances – are targeted explicitly to low-income families. But both are funded locally and involve significant local decision making. Consequently, one anticipates large place-to-place differences in the benefits received by similar households, in part because of differences among oblasts and local governments in their resources.

### *Moldova*

As a result of various reforms, Moldova<sup>6</sup> now has three primary vehicles for delivering social assistance:<sup>7</sup> Energy and Housing Subsidies (EHS), Family Allowances (FA), and Social Assistance (SA).

In 2000, a broad range of benefits and privileges paid to numerous categories of citizens was replaced with payments for heating and electricity to a more restricted group of nine categories. The categories include four groups with varying degrees of disability, Second World War participants and their wives, certain persons associated with Second World War veterans, single pensioners, families with four or more children under 18, and families of Chernobyl disaster workers who died. Beneficiaries get either a 50 percent or 25 percent discount on energy and housing expenditures; most get the 50 percent benefit. Two-thirds of benefits are for heat expenditures. A certificate authorizing the discount is issued

by local authorities. While it is widely agreed that many in these categories are vulnerable, not all are; and experts argue that targeting could be improved.

Family allowances consist of two parts: universal birth allowances, which provide assistance until the child is 18 months old, and means-tested (per capita family income) allowances for children aged from 18 months to 16 years.

Finally, Social Assistance serves several distinct populations. Social pensions go to those of retirement age who do not qualify for a pension. One-time payments are made by local governments, typically on an emergency basis. Payments are made to the families of children with disabilities. None of these payments is income-conditioned.

In summary, Moldova has made less progress than Kazakhstan in rationalizing its social assistance. It has reduced the number of categories qualifying for assistance and sharply simplified the benefit structure. But the system generally retains the Soviet-era category basis for determining eligibility, and a 'second filter' of income-testing is applied only for child allowances. Additionally, the EHS programme provides benefits in kind. Unlike Russia and Kazakhstan, subnational governments have little responsibility for funding benefits. Overall, both countries went further than Russia in simplification, monetization, and targeting.

### **Conclusions**

Monetization of privileges should have tackled several key issues, such as permitting wider client choice of services through the introduction of cash payments, improving targeting and transparency, and adjusting the forms of social support to the needs of the population. It should have helped also to bring public social liabilities within budget constraints. Several pilot projects, regional and local, replaced transport or housing in-kind benefits with cash subsidies and proved the efficiency of this approach, as is shown in Ragozina (2004). But as of today, the national reform is far from reaching these goals: categorical eligibility remains untouched, no targeting is envisaged and just a handful of privileges are removed, mostly concerning occupational benefits such as free city transport for police or fire brigade employees. More than that, delineation between 'federal' and 'regional' groups of recipients is non-transparent and is not

clear either to the population or even the authorities. Bungled reform implementation has made the population very wary of any new initiatives.

With the regions given responsibilities for larger groups (labour veterans are the largest group of privilege recipients), they are having more difficulty matching their resources and obligations. Regions have received mixed political signals from the federal level and have strong disincentives to introducing targeting or at least to cashing-out most of the in-kind privileges. It is no surprise then that Russian regions responded to the contradictory federal legislation with a great degree of caution and have largely lost an opportunity to better target their social protection resources to the poor. The majority of regions retain in-kind privileges such as free provision of solid fuels, dental prosthetic services, even spa treatment (to victims of political repression). Some very positive attempts can be seen, though. These include the reform of housing privileges, despite the fact that federal legislation did not touch them. A few regions decided to cancel these privileges and introduce cash benefits, which is the most rational decision, because the programme of housing subsidies for the poor has been operating in Russia for several years and is sustainable enough to protect low-income households.<sup>8</sup>

The law defining the reform rules has not created a window of opportunity for the Russian regions to transform inefficient and poorly targeted systems of categorical in-kind privileges into a more targeted mechanism of social protection. The 'non-worsening' ideology makes it unlikely that more social resources will be targeted to low-income groups, which directly contradicts one of the main unsolved problems, declared by the state as a priority: the need to alleviate poverty. Targeting is needed not only to balance state liabilities with budget resources, but to respond to the failure of the categorical system in dealing with poverty. Privileges do not need to be entirely removed: any society may define its system of recognitions and awards, but these should be placed outside social protection. Social protection, separated from merit recognition, should focus on the poor and socially vulnerable households. It has to be made more efficient in addressing the needs of this client group, through the introduction of cash transfers designed in a way which does not bring negative incentives to work, and through the transformation of social services to

address the basic needs of the clients, not providers or funders of social assistance.

The reform of in-kind privileges in Russia can be assessed as making very limited progress, compared to what it could have achieved and what other CIS countries have accomplished. Somewhat improved accounting, modest results in transition towards cash benefits and zero progress in introduction of targeting do not appear worth the implementation difficulties and political price paid to calm protests by the population. The government needs to learn that implementation details and work with clients matter, and have to be strengthened at all levels through quality control, training and outreach/feed-back collection work with the population.

The difficult task now is to bring poverty alleviation programmes back to the attention of public authorities and to encourage regions financially to cash-out more privileges and to target benefits to the poor. Housing privileges alone are equivalent to 2.4 percent of GDP (World Bank, 2004b), but still have to be replaced by targeted assistance, despite the housing allowance programme being in place for a decade. It is hard to understand this situation when regional budgets have to be balanced against the new liabilities taken on in 2005, in the absence of proper preparation and assessment of the implications. These challenges are now greater than before, since they have to be faced in the situation when trust in reforms has diminished even further.

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#### *Notes*

- 1 For a description of intergovernmental fiscal relations during these years, see Freinkman et al. (1999) and Saburov et al. (2001).
- 2 This literature has summarized the context of Russian municipalities' implementation of innovative programmes in Struyk (2005).
- 3 See, for instance, Gontmakher (2004).
- 4 See: [<http://www.rian.ru/politics/russia/20050524/40407770.html>].
- 5 This section is based on World Bank (2004a) and unpublished Bank documents.
- 6 This description is broadly based on unpublished materials prepared by Emily Andrews.

- 7 Omitted from this discussion as well as that for Kazakhstan is funding for institutional care of orphans, the mentally ill, and other groups.
- 8 The programme is described in Lykova et al. (2004).

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